

MINUTES  
JOINT LEGISLATIVE STUDY COMMISSION  
ON  
THE MODERNIZATION OF NORTH CAROLINA BANKING LAWS

Monday, December 19, 2011

The Joint Legislative Study Commission on the Modernization of North Carolina Banking Laws met on Monday, December 19, 2011 at 10:00 a.m., Room 544 Legislative Office Building, Raleigh, North Carolina.

In attendance were Senator Brown (Chairman) and Representative Brubaker (Chairman); Senators Blue and Blake; Representatives Daughtry, Jordan, McComas and Earle; Christopher Kukla, Gray Reed, Charles Whitehead, Jr., and Andrea Young. Ryan Blackledge (Bill Drafting Staff), Drupti Chauhan (Research Staff), Karen Cochran-Brown (Research Staff) and Greg Roney (Research Staff) were present. Committee Assistants Darryl Black and Cindy Coley were present.

Senator Brown, Chairman, called the meeting to order and recognized House Sergeant-At-Arms Staff Larry Elliott and Reggie Sills; and Senate Sergeant-At-Arms Staff William Fritscher and Steve Wilson.

Senator Blake made a motion to approve the minutes from the Nov 21, 2011 meeting. Mr. Charles Whitehead seconded the motion and the motion was approved unanimously.

Three documents were included in committee member notebooks and distributed for review related to the presentation:

- Attachment 1 - Summary of Proposed Changes to N.C. Banking Law (Articles 1A - 3A)
- Attachment 2 - Current Banking Law Sections Corresponding to Proposed Changes to NC Banking Law
- Attachment 3 - Banking Law Modernization Act (Bill Draft 2011-ROz-10 [v.2])

Documents related to this presentation have been placed on the Banking Commission public website.

**Presentation**

Senator Brown, Chairman, introduced North Carolina Commissioner of Banks Joseph A. Smith, Jr.

Commissioner Smith emphasized the importance of this effort and thanked staff for their assistance. Commissioner Smith stated that this meeting's focus would be:

- To provide a section-by-section review of draft legislation for Articles 1A, 2A and 3A of the Banking Statutes
- To address any questions that may arise
- To cover comments that have been received from the public circulation of work
- To review any substantive changes the Banking Commission recommends

Commissioner Smith stated that a number of discussions with stakeholders have been held and requested that commission members inform his organization whether there are any missing stakeholders. Several comments have been reviewed and it is likely more will be received in the future. Current stakeholders contacted by the Banking Commission include:

- NC Department of State Treasurer (Treasurer is the Chairwoman of the Banking Commission)
- NC Department of Commerce
- NC Center of Responsible Lending (represented on committee)
- NC Justice Center
- NC Banker's Association
- NC Manufactured Housing Association
- NC Association of Realtors
- NC Department of Justice
- NC Bar Association (primarily the Business Law Section)
- NC Homebuilders Association
- NC Association of Mortgage Professionals (trade group for mortgage brokers)
- Mortgage Bankers Association of the Carolinas

Chairman Brubaker requested clarification on stakeholder feedback. Commissioner Smith replied that there was some feedback from the Justice Center that will be discussed later in this meeting. Commissioner Smith replied that the Banker's Association has provided several drafting points which are immaterial that will be discussed in later provisions and that a few other stakeholders has produced comments that are not being discussed in today's agenda.

Commissioner Smith stated that the pending bill has been framed as an amendment to the existing Chapter 53 law and that today's presentation will focus on Articles 1A, 2A and 3A (**See Attachment 1**). Commissioner Smith then proceeded to discuss proposed provisions related to Article 1A "General Provisions".

- § 53-1-1. "Title" consists of a slight chapter title change to "Regulation of Banks and Other Financial Services".
- § 53-1-2 "Scope and applicability of Chapter" is essentially a non-controversial transition clause or jurisdictional statement.

- § 53-1-3 "Existing banks; prohibitions, injunctions" states that a bank cannot be a NC charter bank without complying with this statute. It also clearly defines what institutions can be called a "bank".
- § 53-1-4 "Definitions and application of terms" have increased from 11 1931-era definitions used before the FDIC or modern banking-era terms to over 70 updated specific terms consistent with current federal definitions. Some examples follow. There will now be defined measures of a level on a capital balance sheet. The term "capital" now means tier 1 capital or equity as covered by the FDIC regulations. "Required Capital" means the amount needed to create a bank. "Inadequate Capital" is the amount when some concern occurs. "Insufficient Capital" is even a lower measure. Additional terms will not be further defined upfront and will be covered during their application at a later time.
- § 53-1-5 "Severability." Referred to Attachment 1.

Chairman Brown asked Commissioner Smith to discuss capital challenges banks are currently facing. Commissioner Smith stated that many state chartered banks, along with those located in the southeast and national banks, share a capital deficiency. This is in part due to a large concentration of commercial real estate lending associated with acquisition and development of land with the intent to subdivide for housing that would be eventually sold. Due to a large influx of standing inventory, a capital deficiency has occurred. Since assets have dropped in value then the liability side must also be impacted - meaning less equity. Banks must then raise capital in a challenging environment. To address this matter, the Banking Commission has been working with industry representatives in attracting capital investments. These investments enable banks to take losses and restructure loans so banks can perform better, resulting in future lending opportunities. This is a large reason why credit is tight today. It is also a major reason why the Banking Commission is currently looking at updating state banking laws and streamlining provisions since it would enable the state to responsibly attract future capital investment. Existing depression-era provisions for surplus and capital-raising for struggling banks are punitive for shareholders and have deterred investors who in many cases are attracted to the state's economy.

Chairman Brown asked Commissioner Smith whether any banks over the past year have been successful raising capital or had a successful stock offering. Commissioner Smith replied that some money has been raised around board tables and through private equity investments (especially from out-of-state firms); however, he was unsure regarding public equity investment. The most impressive recent investment was the FNB United and Bank of Granite \$310 million recapitalization effort. Though a state bank was lost (it is now national), the bank was able to secure capital in order to survive. Recommended law updates will essentially be "setting the table"; however, state banks will still be responsible in securing actual funding.

Senator Blake wanted to know whether the TARP funding program was complete. Commissioner Smith stated that though many of the larger banks such as BB&T have

repaid their TARP funds, there are still a number of banks that have outstanding treasury investments with a fixed interest rate of 5% that can be deferred. A deferral beyond six payments enables the U.S. Treasury to be able to appoint directors (it does not take over bank or put it out of business). After five years the dividend rate would increase from 5% to 9%. The Banking Commission advised banks that wished to participate in the TARP capital program to have an exit strategy. All stated that they did and this has not been the case. There are still a number of banks carrying TARP capital. Some banks have secured financing from the Treasury Small Business Loan lending program (\$30 billion capacity, \$11 billion requested in U.S., and \$4 billion invested in U.S.). North Carolina banks have obtained over \$100 million of small business loans with two-thirds of this funding being used to refinance TARP capital, resulting in even more criticism. Though TARP has a fair number of critics, it did help many banks and overall has not cost taxpayers anything since the large banks have rapidly paid back loans.

Senator Blake remarked that balance sheets indicate that some banks have received about \$50 million to \$60 million from the federal government. Senator Blake asked whether this was normal. Commissioner Smith replied that the US Treasury did not necessarily want to offer limited-term investments in banks and that the ultimate goal was to help small businesses by having an attractive cost of investment (in some cases the rate can go down to 1%). Commissioner Smith then emphasized that banks are looking for capital from anywhere.

Chairman Brown then added he understood that only about six banks have participated. This figure was confirmed by Commissioner Smith.

Senator Blake inquired whether the program was actually working. Commissioner Smith believes it is still too early to tell. Some banks prefer using the state Rural Center's capital access initiative as an additional guarantee program for small business lending. Outside of the real estate community, including developers which still has lending problems; small operating businesses have so far produced a weak demand for lending services.

Commissioner Smith then discussed the proposed provisions related to Article 2A. "Commission and Commissioner".

- § 53-2-1. "The Commission." The existing structures for the Commission and Commissioner are good since they provide an adequate mixture of independence and accountability with regards to the chartering of banks. After serving as Chairman of the Conference of State Bank Supervisors, Commissioner Smith realized that state banking commissioners who are appointed by the Governor often come and go simply at a governor's discretion. He stated that in North Carolina, a banking commissioner is appointed to serve for a number of years by the Governor who is an elected official and must be confirmed by both legislative bodies. Oversight of the banking commissioner comes from an independent agency with members appointed by the elected officials who also serve for a number of years. The Banking Commission is also subject to legislative priorities.

As a result, this section has not changed significantly. This section would drop the current requirement of two CEOs from state savings institutions. This measure originated about 2002 with the Savings Institution Division merger. Currently there are about 80 banks of which 20 are savings institutions of which most of their presidents have already served, therefore creating a mismatch. Nobody from other industries serve on the commission. Public members are members who are not practical bankers whereas practical bankers must now have served in a leadership role. The new definitions of "practical banker" and "public member" are meaningful in the context of this section.

Chairman Brubaker inquired whether 19 members were appropriate or perhaps too many. Commissioner Smith believes that the number of commission members may have increased after the merger with the savings and loan division. Commissioner Smith did not have a preferable number in mind and felt recommending the number of members was inappropriate. In the past, the Banking Commission has had to act as an "appellate court" with a number of panels.

Chairman Brubaker inquired about the number of commission members in other states. Commissioner Smith used Virginia as an example. There the Virginia State Corporation Commission consisting of three judges oversees a banking commissioner. North Carolina once had a Corporation Commission that was dissolved in the 1930s. Commissioner Smith said that most other states do not have a similar banking commission structure and that he would need time to research this request.

Chairman Brown inquired whether the composition that included practical bankers and public members was reasonable. Commissioner Smith stated that he was satisfied with the composition of the board and again stated that this was not a priority. The intent was to keep items that did not have to be changed the same and to stay away from political matters such as recommending the number of appointments an elected official could make.

- § 53-2-2. "The Commissioner." This provision carries forward existing law and will permit the Banking Commission to continue enforcement of consumer protection laws. There are two reasons for this. First the Banking Commission already has a consumer outreach group that is not authorized by legislation that the Banking Commissioner considers of value. Next there is currently a federal consumer protection department that is currently without a director. Though the impact on state banking from this federal agency is still somewhat unclear, consumer compliance should be viewed as a risk management tool for potential intensified federal review in the future.

Senator Blue wanted to know the amount of coordination between the NC Department of Justice and the Banking Commission. Commissioner Smith stated that their consumer compliance teams often work together. Commissioner Smith

then stated that much of the recent attention in the consumer area has not necessarily been focused directly on banking but on the mortgage and check cashing industries. Though there is currently a long list of federal consumer requirements that have in large been supported with federal agencies, Commissioner Smith does not see his group's efforts as being redundant since they are essentially risk management related. The Banking Commission has worked with Attorney General's office and local law enforcement on criminal matters such as employee theft, fraud and embezzlement.

- § 53-2-3 "The Office of the Commissioner of Banks." This provision simply pulls together provisions of existing laws.
- § 53-2-4 "Administration of the Office of the Commissioner of Banks." discusses general capacity and maintains the current timetable for developing the annual budget.
- § 53-2-5 "Rulemaking." This provision discusses rulemaking with little substantive change. It clarifies that the final agency action is when the Banking Commission approves the proposed regulatory rules. In the past, the Chairman and the Commission may have had different opinions towards rulemaking authority, in part due to shifting law. Though the Commissioner can propose rules, these rules must still be approved prior to going to the Rules Review Commission. This measure provides proper oversight without requiring an excessive number of rules.

Representative McComas wanted confirmation that the Banking Commission was still subject to Rules Review Commission. This was confirmed by Commissioner Smith.

- § 53-2-6 "Hearings and Appeals." This provision provides little change and just streamlines rules.
- § 53-2-7 "Official records." Commissioner Smith stated as a regulator, the Banking Commission must maintain documentation in a confidential manner. Examples of some documents not public record include private financial transactions that are not yet public or personal financial information such as net worth and social security numbers. The recommended change would carry forward the provision of current law allowing sharing of records with other governmental agencies, including law enforcement agencies or by subpoena. Due to the retention of these records, some private groups have found the Banking Commission to be a good source of information. Commissioner Smith is concerned that without such updates, the Banking Commission could inadvertently get in the middle of future private or civil litigation matters, areas that can be discovered in another more appropriate manner. Public disclosure can have an adverse impact on potential enforcement actions. States, such as Florida which has a sunshine act, can present a challenge with multi-state actions.

Senator Blue inquired whether this measure would adversely affect a judicial official from imposing a confidential order then allowing discovery. Commissioner Smith believes though there have been times the Banking Commission has wanted to resist such discovery, whenever so ordered; the Banking Commission has always produced requested records. L. McNeil Chestnut, Special Deputy Attorney General, Banking Commission, further added that he has defended several of these actions and this measure is strictly focused on private civil litigation matters involving bank examination reports that can contain highly confidential information. A judge will still be able to require that confidential information not be publicly disclosed prior to discovery. This is also important since sometimes these confidential reports may involve joint state and federal action.

Senator Blue asked whether the information is available directly from the source. Mr. Chestnut stated that financial institutions often have a report of examination and that a plaintiff's attorney may attempt to discover this report. This can result in a motion to intervene by the Banking Commission counsel since the report has confidential information such as rating and sensitive examiner notes. If the official records of the Office of the Commissioner of Banks were public, it may affect how examiners express themselves.

Senator Blue then asked whether the underlying information would still be available. Mr. McNeill confirmed that the underlying information would still be available directly from the banks. Commissioner Smith reiterated that though private parties may sue each other or make motions, the Banking Commission would rather not be the vehicle in which this type of discovery is made.

Mr. Christopher Kukla asked whether this measure could potentially hide complaints. Commissioner Smith replied that consumer complaints may contain private confidential information such as financial matters. That if consumers or legal counsels wish to obtain this data, they could still go directly to the source, since the information had to be provided to the banks in the first place. The Banking Commission always suggests to interested parties that if they are dissatisfied, that they should consider legal counsel. With regards to overall complaints, the Banking Commission publishes aggregate complaints not by institution which has its own issues. The main interest here is consumer protection.

Ms. Andrea Young asked with regards to confidentiality, whether there could be a policy distinction between depository and non-depository institutions. Commissioner Smith stated that the Banking Commission has received a suggestion in this area especially with regards to loan servicers. The Banking Commission has been working with the Justice Center to look into this matter. One challenge with consolidating confidentiality requirements is that it could

inadvertently sweep up different areas. Commissioner Smith agreed to follow-up on this matter.

Commissioner Smith then discussed the following proposed provisions in Article 3A "Organization of a Bank".

- § 53-3-1 "Application to organize a bank." Commissioner Smith stated that though banks are incorporations- corporations are not necessarily banks. The charter is the document conferred that gives one the authority to open and serve the public. This provision permits an applicant to be a Limited Liability Corporation or LLC. The Banking Commissioner conducts an examination. The application information includes information on investors. Documentation now matches up to federal and FDIC-standard forms with local requirements. Since rulemaking has gotten more stringent and time-consuming, the fee schedule is now included within statute. If changes are needed, the Banking Commission will return to the General Assembly.
- § 53-3-2 "Permission to organize a bank." Commissioner Smith referred to Attachment 3, page 11, and discussed how after examination, organizers as individuals, can file and continue organization work. They cannot start banking until a charter is received and during the organizational process, the Banking Commissioner is in charge.
- § 53-3-3 "Articles of incorporation of a proposed bank." Commissioner Smith referred to Exhibit 1.
- § 53-3-4 "Commissioner's approval of charter issuance." Commissioner Smith referred to Attachment 3, page 12, and briefly covered the nine requirements required before charter approval.
- § 53-3-5 "Notice; public hearing." Commissioner Smith states that a hearing is available if there is opposition.
- § 53-3-6. "Commission decision." Commissioner Smith referred to Exhibit 1 and stated that applicants may follow an appeals process through the courts.
- § 53-3-7 "Issuance of charter." Commissioner Smith stated that this provision provides the Banking Commission's role for making inquiry, authorizing or denying a charter. Though more explicit with the separation of incorporation matters for establishing a charter, it has similar provisions as previous law. This provision also refers to markets instead of communities with the intent that some banks may be established for a special purpose such as venture capital firms that are not necessarily local.

Commissioner Smith then invited further discussion from committee members.



Mr. Christopher Kukla had a question regarding the characterization of organizers and wanted to know if proposed changes may preclude someone from making public comments about a bank officer who had not effectively served a previous community. Commissioner Smith stated that he believes consumer confidence is important and would like to address any such concerns.

Chairman Brown asked that Commissioner Smith to further discuss capital requirements. Commissioner Smith stated that he is hopeful that over time, there can be a return to a level of capitalization in the industry that will make it a more attractive investment. The industry still needs some restructuring to occur and there may be an issue of what is considered a sufficient amount of capital. It is difficult and expensive to raise additional capital. Many current investors are looking for a good value with a decent return that may sometimes need to be squeezed out of existing operations. We still need to figure this out. He further added that savings banks and S&L laws are not included in this statute, mainly because this statute focuses on stockholder-based efforts and does not allow for mutual-owned organizations. There may be a point in time in which a review of mutual organizations that serve small communities and specialized markets or firms not focused on capital markets needs to occur. Commissioner Smith proposed that the needs of the main body be currently considered and that other laws be addressed in the future.

Chairman Brown requested an update about the regulatory side involving the FDIC and Federal Reserve. Commissioner Smith expressed that some bankers believe that the federal government wants to “put them out of business”. He added that last year the FDIC fund did not have any money and now is in pretty good shape. Federal regulators were badly burned by critical federal Inspector General reports identifying weaknesses in controls and concentrations of real estate that had not been recognized. Unfortunately this is pro-cyclical which means that when regulators should have loosened up, enforcement instead increased. When things were great, perhaps someone should have stepped on the brakes. The only cure for this is to work through the situation.

Senator Blake stated that he has heard that FDIC-imposed fees are presenting a challenge. Commissioner Smith stated that there were years in which depositors essentially obtained insurance for little or nothing. He said that many thought that this was not a good idea in the first place and the FDIC now bases the amount of insurance cost assessed on the risk of a bank. Ray Grace, North Carolina Banking Commission Chief Deputy, further added that the FDIC has indeed changed to a risk-based premium. A big problem community banks had was when after the FDIC fund was “challenged”, one solution included a move to a three-year prepayment of deposit insurance. This was a big expense for banks when they could least afford it. The federal Dodd-Frank Act brought some relief for smaller banks, while larger banks had an increased burden to bear.

Senator Blake stated his concern about how foreclosures are being handled often through large national banks. Senator Blake believed that some level of consumer protection in this matter should be handled by the state. Senator Blake added that in many cases, current property values are below previous values and there is a potential for the problem

to get worse in the future since many foreclosures are still on the books. He also believes that the state should look at somehow encouraging banks to expedite the foreclosure process by either writing them off or allowing consumer resolution. Commissioner Smith replied that he commended the General Assembly for an existing statute that has allowed for the restructuring of about 1,000 loans a month. Commissioner Smith then stated that one area being considered is the exemption of mortgage servicing firms from confidentiality provisions. There are many problems pending and there is some discussion of a forthcoming settlement with many attorneys general. The Office of Comptroller of the Currency has them under public orders to change their processes. Again there is much activity in this area and Commissioner Smith stated he would be glad to look into this issue further.

Mr. Charles Whitehead, Jr. added that though he supports a risk-based approach, community banks have experienced difficulty with the timing and amount of the FDIC premium increases. As a matter of perspective, his bank which is a small \$300 million institution was once assessed about \$40,000 in premiums which has now jumped to \$678,000 per year. This occurred in the April-May timeframe, several months after budgets were in place and included an expectation of profitability. In addition, to make matters worse, in order to bring the fund back up, a three-year prepayment assessment of \$1.3 million in cash by the end of 2010 was required, presenting a challenge to a small profit-based institution. Commissioner Smith stated that the issue wasn't necessarily one of lack of liquidity since the FDIC could have borrowed against a US Treasury line of \$500 billion. However the chairwoman wanted to keep this a bank-funded matter especially following previous bailouts.

Senator Blake stated he is nervous about the federal government telling national banks to absorb bad paper and stated that the federal government should have instead taken a more proactive approach. Though Senator Blake supports institutional profits, he is concerned that risk may be inadvertently shifted back to the public taxpayer. Commissioner Smith replied that it is unlikely that the federal government in the near future will intervene in the mortgage market, but again this is a complicated matter.

Representative Jordan asked Commissioner Smith to talk about the composition of the Banking Commission. Representative Jordan stated that under existing law the Governor has 19 appointees (11 public, 5 practical bankers and 2 CEOs of state savings institutions) and the Speaker of the House and the Senate Pro-Tem each have 1 appointment. Representative Jordan wanted to know where the other 1 came from. Commissioner Smith believed that the difference may have come about from earlier amendments; however, under the proposed law believed this matter would go away.

Chairman Brubaker requested staff to strike 19 to 21 figures and go back to a figure of 15 using previous law before the S&L merger. Representative Jordan stated that he believed under the proposed law there now appears to be three wild cards (19 governor appointees of which 5 practical and 11 public members) and wanted to make sure that any amendment would care of a discrepancy. Commissioner Smith will make sure that this point is addressed.

Representative Jordan then made a point that the proposed law appears to define practical bankers as being defined as banking leaders and public members as not being practical bankers. Commissioner Smith stated under the proposed language, in theory, a bank staff individual could be a public member and that this was never the intent. Representative Jordan then stated he believed it appears perhaps some language may have been stripped out that needs to be reviewed. Commissioner Smith replied that he would be receptive to inserting language that a public membership be further defined as a public member not affiliated with a bank.

Chairman Brubaker and Chairman Brown announced that the next meeting will be held on January 20, 2012, 10:00 a.m., 544 Legislative Office Building, Raleigh, North Carolina. There being no further business, the meeting adjourned at 11:30 a.m.

The following is a reminder of the tentative Committee schedule for the recommended revisions to the Banking Statute:

January:	Articles 4 and 5
February:	Articles 6 and 7
March:	Articles 8 and 9
April:	Article 10

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Senator Harry Brown, Chairman

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Representative Harold Brubaker, Chairman

ATTEST:

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Darryl Black, Committee Assistant